



HM TREASURY

Financial Reporting Advisory Board Paper

IAS 40 *Investment property*

Issue:	The application of IAS 40 <i>Investment property</i> in the context of resource and other accounts covered by the Government Financial Reporting Manual (FRoM).
Impact on guidance:	The proposed text in Annex A relates to the IFRS-based FRoM.
IAS/IFRS adaptation?	Yes – proposed adaptation to take revaluation movements to equity.
IPSAS compliant?	No – adaptation and interpretation.
Interpretation for the public sector context?	Yes – to require use of the fair value model.
Impact on budgetary regime?	No.
Alignment with National Accounts	Yes.
Impact on Estimates?	No.
Recommendation:	That the Board agree to apply IAS 40 as adapted and interpreted.
Timing:	Not yet known: depends on future decision on date for moving to EU-adopted IFRS.

DETAIL

Background

1. IAS 40 *Investment property* was revised in 2003 to be applied for annual periods beginning on or after 1 January 2005, replacing the 2000 version of the standard.

Objective of IAS 40

2. The objective of the Standard is to prescribe the accounting treatment for investment property and related disclosure requirements.

3. The principal issues for consideration within the Standard are therefore identified as recognition, measurement and disclosure of investment properties.

Scope

4. The Standard *does not* apply to:

- a. Biological assets related to agricultural activity (IAS 41 *Agriculture*);
- b. Mineral rights and reserves such as oil, natural gas and similar non-regenerative resources.

5. The Standard *does* apply to the following specific items in relation to leasing:

- a. The measurement in a lessee's financial statements of investment property interests held under a finance lease; and
- b. The measurement in a lessor's financial statements of investment property provided to a lessee under an operating lease.

Other Standards (such as IAS 17 *Leases* and IAS 18 *Revenue*) deal with the recognition, measurement and disclosure of other lease arrangements.

Definition

6. Investment property is property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation, or both.

7. The following are *not* investment property, and are therefore outside the scope of IAS 40:

- a. Property intended for sale in the ordinary course of business or in the process of construction or development for such sale (IAS 2 *Inventories*);
- b. Property being constructed or developed on behalf of third parties (IAS 11 *Construction Contracts*);
- c. Owner-occupied property (IAS 16 *Property, Plant and Equipment*);

- d. Property being constructed or developed for future use as investment property (IAS 16 *Property, Plant and Equipment*); and
- e. Property that is leased to another entity under a finance lease (IAS 17 *Leases*).

Initial recognition and measurement

8. Investment property is recognised as an asset when, and only when:
- a. it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and
 - b. the cost of the investment property can be measured reliably.
9. Investment property is measured initially at cost. Transaction costs are included in the initial measurement. Such costs should not include:
- a. start-up costs (unless they are necessary to bring the property to the condition necessary for it to be capable of operating in the manner intended by management);
 - b. operating losses incurred before the investment property achieved the planned level of occupancy; or
 - c. abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.

Subsequent measurement

10. IAS 40 permits an entity to use either the fair value model or the cost model for the subsequent measurement of investment property. The policy chosen should then be applied to all its investment property:

- a. Fair value model: The fair value of investment property is the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction. A gain or loss arising from a change in the fair value of the investment property must be included in net profit or loss for the period in which it arises;
- b. Cost model: After initial recognition, investment property is accounted for in accordance with IAS 16 *Property, Plant and Equipment* (i.e. at cost less accumulated depreciation and impairment losses), unless it is classified as held for sale, in which case it should be measured in accordance with IFRS 5.

Disposal

11. An investment property should be derecognised on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.

12. Gains or losses arising from the retirement or disposal of investment property are calculated as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised in net profit or loss in the period of the retirement or disposal.

Generic Disclosure requirements

13. For both the fair value model and the cost model an entity is required to disclose:

- a. whether it applies the fair value model or the cost model;
- b. if applying the fair value model, whether property interests held under operating leases are classified and accounted for as investment property;
- c. when classification is difficult, the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business;
- d. the methods and significant assumptions applied in determining the fair value of investment property;
- e. the extent to which the fair value of investment property is based on a valuation by a qualified independent valuer. If there has been no such valuation, that fact must be disclosed;
- f. the amounts recognised in profit or loss for:
 - i. rental income from investment property;
 - ii. direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period;
 - iii. direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period;
- g. the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal;
- h. contractual obligations to purchase, construct, or develop investment property or for repairs, maintenance or enhancements.

Additional disclosures for the fair value model

14. In addition to the generic disclosures above, an entity applying the fair value model shall disclose:

- a. a reconciliation between the carrying amounts of investment property at the beginning and the end of the period, showing additions, disposals, fair value adjustments, net foreign exchange differences, transfers to and from inventories and owner-occupied property, and any other changes;
- b. any significant adjustments to a valuation obtained to arrive at the valuation included in the financial statements;
- c. if an entity that otherwise uses the fair cost model measures an item of investment property using the cost model, specific additional disclosures are required.

Additional disclosures for the cost model

15. In addition to the generic disclosures, an entity applying the cost model shall disclose:
- a. the depreciation methods used;
 - b. the useful lives or the depreciation rates used;
 - c. the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period;
 - d. a reconciliation of the carrying amounts of investment property at the beginning and end of the period, showing additions, disposals, depreciation, impairment recognised and reversed, net foreign exchange differences, transfers to and from inventories and owner-occupied properties, and any other changes.

Main differences from UK GAAP (SSAP 19 Accounting for Investment Properties)

16. Measurement bases that may be used

Under IAS 40 an entity may choose to apply either the fair value model or depreciated cost model to all of its investment property (with some specified exceptions). SSAP 19 requires investment properties to be held at open market value.

17. Recognition of gains and losses on revaluation

IAS 40 states that gains or losses arising from changes in fair value should be recognised in the income statement. Under SSAP 19 such gains and losses are recognised in the Statement of Total Recognised Gains and Losses (STRGL), unless it is a permanent deficit (or its reversal), in which case the charge (or credit) is taken to the profit and loss account.

Impact of IAS 40 on the public sector

18. IAS 40 is likely to impact on only a small number of entities covered by the requirements of the FReM. Subject to the adaptation and interpretation proposed in paragraph 20 and Annex A, there will be little change to current accounting.

Impact on disclosures in resource and other accounts

19. Although the disclosure requirements of IAS 40 are more extensive than SSAP 19 they are not considered to be onerous.

20. The presentation and disclosure requirements of IAS 40 will be taken into account in developing the format of resource and other accounts in light of the move to EU-adopted IFRS and other initiatives.

IAS/IFRS compliance

21. An *interpretation* of IAS 40 is proposed to require use of the fair value model, i.e. for the public sector context, it is proposed that the IAS 40 option of subsequent measurement at cost be withdrawn. This is in line with the interpretation of FRS 15 in the current FReM.

22. An **adaptation** to IAS 40 is proposed to limit the impact of unrealised gains and losses on profit or loss by adopting an approach consistent with the treatment of property, plant and equipment under IAS 16, i.e. changes in the fair value of investment properties should not be taken to the income statement, but should be taken to the Statement of Changes in Equity or, where the statement only details realised and unrealised gains, the Statement of Total Income and Expense (STRGL equivalent). Consistent with this adaptation, impairment should be accounted for in accordance with IAS 36 (as adapted).

23. The key reasons for this adaptation are as follows:

- a. Recognition of unrealised gains and losses in the operating cost statement can increase the volatility of that statement and does not necessarily enhance transparency; an entity's operating results may not be readily identifiable;
- b. The budgetary impact of accounting for unrealised gains and losses in the operating cost statement rather than through reserves can be negated by applying specific budgetary rules for those entities impacted. However, this undermines the principle of a 'clear line of sight' between the estimating process, resource accounts and national accounts.
- c. A similar adaptation has been proposed for IAS 41 *Agriculture*.

IPSAS compliance

24. IPSAS 16 *Investment Property* is drawn primarily from IAS 40 and there are no fundamental differences between the two standards. The adaptation proposed is therefore an adaptation of IPSAS 16 as well.

Proposed text for the IFRS-based Government Financial Reporting Manual

25. See Annex A for the proposed amendments to the shadow FReM.

Impact on the budgetary regime

26. The proposal (as adapted) will have no impact on the budgetary regime.

Summary and recommendation

27. IAS 40 *Investment property* sets out the accounting treatment for investment property and the related disclosure requirements. It deals with the recognition, measurement and disclosure of investment property. Unlike SSAP 19 the standard will permit (in most cases) an entity to choose between either a fair value model or a depreciated cost model for measurement after recognition; it also requires any gain or loss on revaluation to be taken to profit or loss for the period. IAS 40 increases the disclosure requirements in relation to investment property.

28. IAS 40 as adapted and interpreted will have no material impact on the way in which investment property is currently accounted for under the FReM.

29. The Board is asked to agree the adoption of IAS 40 as adapted and interpreted.

HM Treasury
12 February 2007

PROPOSED TEXT FOR THE IFRS-BASED GOVERNMENT FINANCIAL REPORTING MANUAL

IAS 40 Investment Property

Applicability

IAS 40 applies as adapted in paragraph a.b.c and interpreted by paragraph a.b.c.

Objectives of IAS 40

The objective of the Standard is to prescribe accounting treatment for investment property and related disclosure requirements.

Interpretation of IAS 40 for the public sector context

In applying IAS 40, entities should be aware of the following interpretation for the public sector context.

Measurement after recognition

All investment property should be accounted for under the fair value model – that is, the option given in IAS 40 to adopt the cost model has been withdrawn.

Adaptation of IAS 40 for the public sector context

The following general adaptations apply to entities required to prepare their financial statements in accordance with the guidance in this Manual.

Measurement after recognition:

- a) Where a property's carrying value is increased as a result of a revaluation, the increase shall be credited directly to equity under the heading of revaluation surplus. However, the increase shall be recognised in the operating cost statement to the extent that it reverses a revaluation decrease of the same property previously recognised in the operating cost statement.
- b) If a property's carrying value is decreased as the result of a revaluation, the decrease shall be recognised in the operating cost statement. However, the decrease shall be debited directly to equity under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that property.
- c) On subsequent disposal of the investment property, the revaluation surplus included in equity may be transferred to the General fund. The transfer from revaluation surplus to General fund is not made through the operating cost statement.

- d) Any reduction in service potential through consumption of economic benefit (e.g. physical damage) or deterioration in the quality of the service provided by the asset, should be treated in line with IAS 36 *Impairment of Assets* (as adapted).